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Decision ___________________________

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Gas Company in Compliance with Resolution G-3304 and of Southern California Gas Company (U 904 G) and San Diego Gas & Electric Company (U 902 G) to Consolidate their Gas Supply Portfolios.	Application 01-01-021 (Filed January 11, 2001)

(Appearances are in Attachment A)

OPINION AUTHORIZING CONSOLIDATED GAS SUPPLY PORTFOLIOS AND GAS ACQUISITION MANAGEMENT

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OPINION AUTHORIZING CONSOLIDATED GAS SUPPLY PORTFOLIOS AND GAS ACQUISITION MANAGEMENT

Summary

We find that the request of Southern California Gas Company (SoCalGas) and San Diego Gas & Electric Company (SDG&E) to consolidate their gas supply portfolios is not in the public interest, and is denied.

Background

On December 11, 2000, SoCalGas filed Advice Letters (AL) 2978 and 2979. At that time the market price of gas delivered at the California border had reached an unprecedentedly high level, both in absolute terms and relative to the market price of gas in producing basins plus the as-billed rate for firm interstate transportation. SoCalGas' average cost of gas had become very attractive compared to alternative supplies available in the marketplace.

In AL 2978, SoCalGas requested that the Commission apply a new formula for determining its monthly procurement rate for noncore customers selecting core subscription service beginning January 1, 2001. In AL 2979, SoCalGas requested that the same formula apply to its noncore customers who requested to transfer to bundled core service after December 1, 2000 (including gas procurement service).

In Resolution G-3304, issued December 21, 2000, the Commission found that if noncore (including wholesale) customers of SoCalGas were allowed to elect core subscription or traditional core service (including procurement service), it would substantially increase SoCalGas' cost of gas for its existing core and core subscription customers. Moreover, the Commission found that SoCalGas' proposal to create a class of procurement service that would be charged an incremental procurement cost was too complicated and speculative to adopt on an emergency basis. Instead, the Commission ordered SoCalGas to suspend transfers of noncore customers (including wholesale customers) to core subscription or traditional core service, except for customers whose gas supply provider was no longer offering service in California if SoCalGas was convinced that such customers would be left without service. Resolution G-3304 also required SoCalGas to file an application to address the issues contained in its advice letters.

On January 11, 2001, SoCalGas and SDG&E jointly filed this application. In addressing the issues required by Resolution G-3304, they propose new rules for eligibility and conditions for core service, the consolidation of the management of SoCalGas and SDG&E's currently separate gas acquisition departments, and the consolidation of the two utilities' gas supply portfolios, including associated storage and interstate capacity.

SoCalGas and SDG&E propose to:

1. Consolidate their gas supply portfolios and related interstate pipeline and storage capacities, and to charge the same cost of gas to utility procurement customers in the SoCalGas and SDG&E service territories.
2. Consolidate the management of their currently separate gas acquisition functions into a single management group, to lower total overhead expenses and promote more efficient gas purchasing.
3. Implement revised uniform rules for their noncore customers wishing to obtain gas supply (or procurement) service from them.
4. Implement revised uniform rules for large core customers who wish to obtain utility procurement

service after having first elected transportation-only service.

5. Allow non-affiliated wholesale customers to purchase gas from the combined portfolio on terms that are reasonable for all affected core gas consumers.
6. Provide that when brokering arrangements elapse for unassigned SoCalGas capacity on the El Paso Natural Gas Company's pipeline (in excess of that which the Commission allocated to the SoCalGas core market in the last Biannual Cost Allocation Proceeding (BCAP)), that capacity should be allocated to the consolidated gas supply portfolio.
7. Allow employees in the consolidated gas procurement function to participate in the negotiation of any power contracts and associated gas supply arrangements by SDG&E that involve "tolling" provisions.

Public hearings were held June 25 and 26, 2001, before Administrative Law Judge (ALJ) Robert Barnett. The matter was submitted subject to the filing of briefs. Briefs were filed by applicants, Office of Ratepayer Advocates (ORA), The Utility Reform Network (TURN), Southern California Generation Coalition (SCGC), the city of Long Beach, El Segundo Power and Long Beach Generation (ES/LB), and the California Industrial Group and the California Manufacturers & Technology Association (CIG/CMTA).

1. Consolidation of the SoCalGas and SDG&E Gas Acquisition Portfolios

SoCalGas and SDG&E propose to consolidate their gas commodity procurement and management functions into a combined gas portfolio which would be managed by a single organization. They request management discretion to determine whether the personnel would be employees of SoCalGas or SDG&E, or some combination thereof. The combined gas acquisition organization would remain separate from the utilities' gas operations organization, as required by SoCalGas/SDG&E merger conditions.[1] They propose that the cost of all gas supplies and associated storage and interstate capacity currently held by SoCalGas and SDG&E and all new supplies and assets be included in the combined portfolio. Currently unassigned El Paso capacity held by SoCalGas would be allocated to the consolidated portfolio to the extent that existing agreements for its brokering expire and is not otherwise committed.

Customers receiving procurement service from SoCalGas or SDG&E would pay the same rate for procurement service (including the cost of interstate capacity and storage). The allocation of the cost of intrastate transportation on the SoCalGas and SDG&E systems would not be affected by this proposal.

Applicants assert that consolidating their gas acquisition management functions and their gas portfolios will generate savings that will be passed through to their gas customers through organizational efficiency. Currently, SoCalGas and SDG&E combined have about 54 people dedicated to gas acquisition functions. They estimate that by consolidating management, approximately 7 to 9 positions can be eliminated. This would produce an overhead savings (salaries, benefits, and associated support costs) of about one million dollars per year. These savings will be reflected in annual performance-based ratemaking (PBR) earnings sharing calculations until the next PBR/Cost of Service proceeding, at which time they will be embedded in the authorized revenue requirement.

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[1] SoCalGas and SDG&E are affiliated companies, both being subsidiaries of Sempra Energy. Their respective parent companies, Pacific Enterprises and Enova,

Footnote continued on next page

Applicants claim additional benefits from consolidation. They say a larger organization would allow for better back-up and training, and better management of turnover. It would allow for improved senior management focus on a single organization. It would reduce the cost, both to the utilities and to the Commission, to regulate two separate portfolios and gas cost recovery incentive mechanisms. They contend consolidation would produce gas cost savings, as well as overhead savings, compared to the combined gas costs of the two utilities operating gas acquisition on a stand-alone basis.

Applicants identified three principal ways in which consolidation will save gas costs:

First, applicants state that the reliability margin of gas in storage (or equivalent assets) that a consolidated portfolio will need to maintain can be somewhat less than the sum that each utility has to maintain when operating on a stand-alone basis. Second, consolidation will allow more economic use of the gas supplies, storage, and interstate capacity of the two utilities, especially of SDG&E's assets. Because of its size, existing trading organization, computer systems, and hub services organization, applicants argue that SoCalGas is better positioned than SDG&E to capitalize on core assets when they are not needed to serve procurement customers. Additional revenues are generated by physical gas transactions (off-system sales), capacity transactions, derivatives, and hub transactions. SDG&E contends that it is handicapped because its size does not support the systems needed to engage in those transactions. Third, increased load and supply diversity from consolidation will be beneficial. The access to

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were authorized to merge in Decision (D.) 98-03-073, subject to a variety of conditions imposed to mitigate market power concerns.

Canadian supplies through the Pacific Gas and Electric Company system that SDG&E brings adds to the diversity of SoCalGas' core portfolio, which has no capacity on that route. Overall, SoCalGas and SDG&E estimate an annual savings of millions of dollars, depending on market conditions.

ORA supports applicants' consolidation proposal. ORA agrees that consolidation will produce 1) more efficient gas purchasing resulting in lower commodity costs because of the greater amount of natural gas being procured and greater diversity of demand being served, 2) more efficient use of storage and capacity assets, 3) greater efficiency in the cost of managing the utilities' gas procurement activities, and 4) regulatory efficiency. ORA also agrees that the combined purchasing power of the two utilities might be sufficient to counteract market power of suppliers, which would benefit California customers.

TURN supports consolidation provided that additional interstate capacity is reserved for the combined portfolio and that the revenue requirements for the two utilities be decreased on January 1, 2002. The city of Long Beach and El Segundo Power, LLC and Long Beach Generation, LLC support consolidation.

SCGC opposes consolidation.[2] It argues that the proposed merger of the core portfolios would improperly require SoCalGas' core ratepayers to subsidize SDG&E's core ratepayers; and insofar as the SoCalGas core has an independent need for reverting El Paso capacity, assigning the reverting El Paso capacity to the combined portfolio would fail to mitigate cross-subsidization of the SDG&E core by the SoCalGas core. SCGC contends that the SoCalGas core needs the reverting capacity for its own purposes, making the reverting capacity

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[2] CIG/CMTA filed a Reply Brief in which it is "adopting various arguments advanced by the SCGC." (Reply Brief p. 1.)

unavailable to offset the impact of combining the core portfolios; that combining the wholesale core loads with the SoCalGas core portfolio would require most of the reverting El Paso capacity that is independently needed by the SoCalGas core; that even if the reverting El Paso capacity were not needed independently by the SoCalGas core, the amount of reverting capacity would be insufficient to prevent the combining of the core portfolios from imposing a burden on the SoCalGas core; that the Sempra companies have proposed combining the core portfolios without analyzing the benefits and burdens on customers; that the Commission should not ignore market conditions and the impact on SoCalGas core ratepayers; and that the better course would be to avoid the benefit/detriment issues by having SDG&E maintain a competitive gas portfolio. Finally, SCGC asserts that assigning the reverting El Paso capacity to core customers without any offsetting benefit is unfair to noncore customers.

Discussion

We are concerned that the benefits of this proposal are primarily theoretical and do not offset the potential downsides to consolidating two of the largest supply and capacity portfolios in the state. The proposal also raises additional questions about the future needs of each utility's customers that the record does not allow us to address.

SDG&E holds interstate pipeline contracts for a small portion of its demand. SDG&E's core procurement load is approximately 125 MMcf/d during an average year, and the utility has 35 MMcf/d of pipeline capacity under contract to serve that load. SDG&E buys much of its customers' remaining requirements at the California border, which historically has been priced lower than the basin price plus the full as-billed interstate transportation rate to get it to the California border. As a result, prior to December 2000 when applicants filed this application, SDG&E's core procurement customers avoided paying the full-as-billed pipeline transportation rate for most of their requirements. SoCalGas, on the other hand, owns interstate capacity rights of 1044 for core that generally match its average daily load, which allows it to buy most of its gas in the production basins. Historically, therefore, in the 33 out of the 42 months prior to November 2000, SDG&E's prices were less than SoCalGas'. At the time this application was filed, however, California border prices were many times the basin-plus-full-transportation rate (and indeed, several times higher than citygate prices nationwide). SDG&E paid significantly more for gas between late 2000 and the early months of 2001. If we consider the historical data, SDG&E would be better off not consolidating.

In D.98-03-073, we approved the merger of SoCalGas' and SDG&E's parent companies. A central focus of that decision was the question of whether the merger at the parent company level would result in market power for either utility company. We agreed with ORA that the advent of a competitive electric market increases the conflicts of interest and potential for market abuses by creating an additional vertical market relationship. We ordered the divestiture of all SDG&E's gas-fired generation facilities in order to mitigate the merged entity's market power and assuage other competitive concerns.

Divestiture of SDG&E's generation facilities notwithstanding, the market power concerns raised by ORA, Imperial Irrigation District and others in the context of the merger proceeding remain relevant today. Indeed, they are even more relevant today. At the time, the companies specifically withdrew from the scope of the merger request the proposal to consolidate their gas procurement operations, so this issue did not factor into our market power analysis then. Furthermore, at the time, many of the arguments supporting the conclusion that the merged parent companies would not have vertical market power, were premised on the assumption that the bulk power market in which the generators served by SoCalGas operate would be highly competitive. Therefore, the argument followed, even if SoCalGas could manipulate gas prices, competition from generators not served by SoCalGas would substantially undercut efforts by SoCalGas to raise (then) PX prices. The experience in the electric wholesale market of the last two years indicates that the competition from other generators element of this assumption, at least, was incorrect.

We further note that the applicants in this case have proposed that the management of their combined gas acquisition department be allowed to assist SDG&E with respect to "tolling"[3] arrangements for wholesale power purchases to serve SDG&E's electric customers. We are concerned that this proposal effectively re-introduces – albeit in a different form -- the electricity generation element that we ordered removed in D.98-03-073 with SDG&E's generation divestiture. It is therefore critical that we consider the market power arguments in this context.

The application goes beyond simply increasing the SoCalGas portfolio by the approximately twelve percent that SDG&E's portfolio would add. It also includes access to information about the electric wholesale market and the

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[3] "Tolling" in the context of power purchase contracts refers to arrangements in which the purchaser of power from a generator provides the gas needed to generate the power, or makes other arrangements such that the generator is not at risk for variation in the price of gas consumed to produce the power. Tolling arrangements have the potential to provide benefits to electric consumers through reduced electric price volatility and ensuring plants are available to meet peak demands.

natural gas requirements of generators in SDG&E's service territory through the tolling agreement proposal. We understand applicants' clarification that they are not proposing any consolidation of tolling gas for SDG&E's electric transactions with the gas supplies and assets in their proposed consolidated gas portfolio to serve their gas procurement customers, and that tolling purchases would not rely upon core assets. Use of core assets to support tolling agreements for electricity generation contracts, however, is a separate issue from the wholesale electricity market knowledge to be gained if the combined utility procurement staff assist in negotiating and managing gas tolling agreements that support electricity contracts.

Furthermore, Applicants and Long Beach have jointly presented a proposal for giving wholesale customers of SoCalGas an option to purchase gas from the consolidated SoCalGas/SDG&E gas portfolio. This proposal provides wholesale customers with treatment comparable to that which SDG&E would receive; that is, it treats core and noncore customers of the wholesale customers as if they were core and noncore customers, respectively, of the consolidated procurement operations.

Taken together, the various proposals contained in this application -- addition of SDG&E's procurement to SoCalGas', the consolidated portfolio's involvement in tolling agreements, and opportunity to add additional wholesale load to the consolidated portfolio – add up to a potentially significant increase in both scale and scope of SoCalGas' existing procurement operations. When considered in context of SoCalGas' unique position as a monopoly provider of gas transportation and storage services, and its access to and control of system information, we are troubled at the prospect of significantly increasing the scale and scope of what is already one of the largest local distribution company procurement operations in the country.

Currently, the separate purchasing activities of SoCalGas and SDG&E contribute, along with PG&E's separate core procurement department, to a significant trading hub at the border where Southwest basin gas enters California. This proposal would effectively remove a significant participant from that market. The applicants have not addressed the impact, if any, of that result; however, we do not see how removing a market participant *increases* market transparency.

We turn next to the benefits of consolidation claimed by the applicants and ORA. They can be summarized as 1) producing gas cost savings; 2) better back-up, training and management; 3) reducing the cost of regulating two separate portfolios, and 4) saving approximately $1 million annually in gas procurement overhead (staffing). We address these points in order below.

First, applicants claim that the reliability margin of gas in storage (or equivalent assets) that a consolidated portfolio will need to maintain can be somewhat less than the sum that each utility has to maintain when operating on a stand-alone basis. Given the key role of stored gas in meeting the peak core demand on SoCalGas' system, and in putting downward pressure on prices overall, it is unlikely that we would view a reduced reliability margin of gas in storage as a benefit.

The applicants further maintain that consolidation will allow more economic use of the gas supplies, storage, and interstate capacity of the two utilities, allowing the consolidated portfolio to capitalize on core assets when they are not needed to serve procurement customers. Certainly, consolidating portfolios expands the assets available for SoCalGas to use in generating additional revenues by physical gas transactions (off-system sales), capacity transactions, derivatives, and hub transactions. The transactions enabled by the use of SDG&E's assets would generate additional revenue to offset the cost of procured gas. However, the record does not establish that use of these assets contributes to a lower cost of actually procuring the gas itself. At its best, this benefit is speculative. At worst, the combination of 1) these additional SDG&E assets with 2) SoCalGas' existing control over interstate, intrastate and storage capacity serving Southern California, and 3) SoCalGas' incentives under its Gas Cost Incentive Mechanism to offset core procurement costs with revenues earned selling gas and capacity to the noncore, could result in higher overall border gas prices – to the detriment of all California gas consumers.

Finally, applicants state that increased load and supply diversity from consolidation will provide gas cost savings. The benefit of supply diversity, however, is something that either utility could acquire absent consolidation of their core procurement departments. Similarly, each utility separately already has at its disposal the tools to ensure reliable service to its respective procurement customers at reasonable and stable prices. Over the long term, SoCalGas and SDG&E could diversify their respective portfolios by acquiring capacity access to Canadian gas (in the case of SoCalGas) or U.S. Southwest-produced gas (in the case of SDG&E). It is not necessary to consolidate the procurement departments to do either.

Second, applicants argue that consolidating the companies' procurement functions will allow for better management, training and back-up. This benefit is theoretical. Applicants have not quantified these benefits, or specified how better training and back-up will occur.

Third, applicants and ORA state that consolidating the core procurement departments will lead to greater regulatory efficiency. The gas procurement activities of SoCalGas and SDG&E are already governed by benchmark incentive mechanisms that are relatively streamlined compared with the prior practice of reasonableness reviews. The "benefit" of conducting one annual incentive mechanism instead of two is unclear, and could actually lead to decreased oversight of the combined utilities' portfolios.

Finally, the approximately $1 million in annual gas procurement overhead savings that the applicants believe they will save is negligible when considered in the context of the utilities' overall portfolios.

These concerns with the consolidation proposal and the lack of significant tangible benefits lead us to conclude it is not in the public interest. We will decline to authorize consolidation of SoCalGas' and SDG&E's core procurement portfolios.

2. Reversion of El Paso Capacity

SoCalGas proposes to allocate to the consolidated portfolio all available unassigned El Paso capacity held by SoCalGas. Since we decline in this decision to authorize the utilities to consolidate their procurement operations, the question of how to allocate unassigned El Paso capacity to the consolidated portfolio is no longer relevant. The disposition of SoCalGas' reverting unassigned El Paso capacity remains an open question, however. We address it here.

SoCalGas currently holds 300 MMcfd of firm capacity on Transwestern Pipeline and 1150 MMcfd of firm capacity on El Paso Natural Gas' pipeline, for a total of 1450 MMcfd. In the last SoCalGas BCAP, the Commission allocated 1044 MMcfd of that capacity (all 300 MMcfd on Transwestern, and 744 MMcfd on El

Paso) to core service. The remaining amount, just under 400 MMcfd (all on El Paso) was unassigned. SoCalGas brokers this capacity, and any shortfall in the brokering revenues from the rate SoCalGas must pay El Paso is recovered by SoCalGas through the Interstate Transition Cost Surcharge (ITCS).

Some of the unassigned capacity is already brokered for the full remaining term of SoCalGas' El Paso contract. The following amounts of unassigned capacity will be available to SoCalGas upon expiration of contracts already signed: On November 1, 2001, SoCalGas will recover 160 MMcfd of capacity; on January 1, 2002, it will recover an additional 50 MMcfd; on March 1, 2003, to comply with existing contracts SoCalGas will transfer to third parties 100 MMcfd; on January 1, 2005, SoCalGas will recover 30 MMcfd of capacity. The amount of capacity that reverts to SoCalGas between November 1, 2001 and August 31, 2006 when the SoCalGas – El Paso contracts expire is never more than 210 MMcfd and after March 1, 2003, significantly less.

SoCalGas' current 1044 MMcfd core allocation is roughly equal to SoCalGas' average daily core load under average weather conditions. SDG&E, on the other hand, has about 125 MMcfd of core load, and about 25 MMcfd of firm interstate capacity from Canada and 10 MMcfd of firm capacity on El Paso (plus 3.6MMcfd capacity recently obtained in an El Paso open season). SDG&E's interstate capacity rights are just under 90 MMcfd less than its annual average core demand.

The record shows that SDG&E's interstate capacity holdings are significantly less than its average daily core load. In this decision, we will not assign to SDG&E or any other customer (including SoCalGas' own core procurement department) the interstate capacity that reverts back to SoCalGas between November 1, 2001 and August 31, 2006. We believe it is prudent, however, for SoCalGas to first make available, consistent with the Federal Energy Regulatory Commission's capacity release rules, this capacity to its wholesale customers and other gas utilities that procure gas for core customers[4]. This flexibility will allow shippers to select the capacity delivery points and terms that best fit their respective needs. The Commission will evaluate utilities' additional interstate pipeline holdings separately.

3. Revised Rules for Core Transportation[5] and Procurement Services

SoCalGas and SDG&E propose revisions to rules applicable to noncore-to-core transfers, and to large core customers switching from transportation-only to bundled core utility procurement service. There appears to be relatively little opposition to SoCalGas' and SDG&E's proposals in these areas. They propose revised rules for their noncore customers wishing to take core transportation-only service or bundled core transportation and utility procurement service. Currently, the two utilities' rules in these areas are somewhat different, both as a result of Resolution G-3304 imposing a moratorium on election of core transportation and core procurement and of other differences adopted in the past. Regardless of whether the core procurement departments of the two utilities are consolidated, it is appropriate to consider uniform rules for election of core transportation and procurement by noncore

[4] Including PG&E, which is not a wholesale customer of SoCalGas but which does procure natural gas on behalf of its own core customers.

[5] Throughout the testimony and briefs, the parties have used the phrase "transportation service" and "transmission service" interchangeably. In this decision we use only the phrase "transportation service." Similarly, we use the phrase, "transportation rate" rather than "transmission rate."

customers generally in California, and we take the opportunity of the record developed in this case to do so for these two utilities. We will consider similar changes as appropriate for PG&E separately.

SoCalGas and SDG&E propose that electric generation, refinery, and enhanced oil recovery (EOR) customers of either utility, any of whom consume over 250,000 therms per year, should not be able to choose core transportation service or bundled core transportation and utility procurement service. Other customers with noncore status, after expiration of any firm contracts they already have with their utility, would have the option to switch to core transportation-only service or bundled core transportation and utility procurement service. Moreover, SoCalGas and SDG&E propose that noncore firm service customers be given a one-time option to cancel their existing firm service contract in order to elect core service, provided the election occurs within three months of the effective date of the new service.

SoCalGas and SDG&E propose that they not be required to accept elections by noncore customers for core transportation service if existing utility intrastate capacity is not sufficient, to prevent service to traditional core customers becoming degraded. Customers electing core transportation service should have to commit to a five-year term, rather than a one-year term as is currently required. They would pay the applicable core transportation rates for their class of service, rather than noncore transportation rates. The utilities point out that because core transportation service means a one-in-35 year level of reliability, additional demands on transmission and storage resources will be created. Transmission and storage facilities are long-lived investments. The utilities believe, therefore, that it is reasonable that noncore customers wishing to switch to core transportation service should have to make a five-year commitment before the utility is committed to long-lived assets necessary to provide that level of service.

The utilities propose that noncore customers switching to bundled core transportation service and utility procurement service be required for the first 12 months to pay a "cross-over" procurement rate. The cross-over rate would be the higher of a) the posted monthly core procurement rate (which will include intrastate backbone costs) or, b) the GCIM monthly benchmark for California border purchases plus the per-unit cost of intrastate backbone costs included in the posted monthly procurement rate (because the California border price alone does not cover the cost of intrastate backbone capacity and it will no longer be recovered in the transportation rate). For the remaining four years, the procurement rate would be the same as charged to core customers.

SoCalGas and SDG&E claim that the combination of the five-year commitment and the cross-over rate for the first 12 months of that five years will be sufficient to prevent price arbitrage and protect existing core customers. The cross-over rate will discourage switching to avoid the impact of short-term border price spikes. The five-year commitment will prevent opportunistic switching in and out of utility procurement service. Also, the five-year commitment will allow the utilities to better plan contracts for gas supply and associated storage and interstate pipeline capacity. SoCalGas and SDG&E recommend that they be allowed to propose by advice letter an additional surcharge to the cross-over rate if the provision turns out to be insufficient to avoid the imposition of significantly higher costs on existing core customers.

The utilities assert that the five-year commitment of a customer consuming over 250,000 therms per year[6] electing core transportation service should carry an 80% use-or-pay requirement (as applied to the core transportation rate) should the customer fuel switch or bypass utility service, as is the case already for noncore customers contracting for firm noncore transportation service (as applied to the noncore transportation rate). The five-year commitment to utility procurement service should carry a 14% take-or-pay requirement in the case of fuel switching or bypass, as now provided for core subscription.

The utilities propose that noncore customers who were already receiving core subscription service before January 1, 2001, should be allowed to switch to bundled core transportation and utility procurement service (with a five-year commitment) on the effective date of this decision, if they are still on core subscription service as of that date, without having to pay the cross-over procurement rate. Currently they receive procurement service at an average portfolio price and did not elect utility procurement service because border prices had spiked.

SDG&E's noncore customers who began core subscription service on and after January 1, 2001, have effectively been paying a rate roughly equivalent to the cross-over rate. Therefore, the utilities' recommend that those customers who elect bundled core transportation and utility procurement service offered as a result of this application should only have to pay the cross-over rate for a period not to exceed 12 months after they commenced core subscription service from SDG&E.

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[6] This category of customer does not include electric generation, refinery, and EOR customers.

In Resolution G-3304, the Commission made special provision for SoCalGas' noncore customers whose gas supplier withdrew from service in California altogether and who in the judgment of SoCalGas would be left without service, allowing them an exemption from the moratorium on new core subscription customers. SoCalGas believes such customers could be exempted from the cross-over rate for utility procurement service, but should be required to make a five-year commitment for core transportation and utility procurement service.

ORA generally supports applicants' proposed rules for noncore customer transfers to core service, but recommends that eligible noncore customers electing transportation-only service be required to make a permanent commitment to that service instead of just five years. ORA agrees that a customer switching from noncore service to core service with its one-in-thirty-five year reliability criteria creates additional demands on transportation and storage resources requiring the utilities to make substantial commitments that generally last a number of years. Therefore, ORA argues, the customer should be required to make a commensurate commitment to taking core service, which in this case should be a permanent commitment. The storage, transportation, and distribution facilities of the utility are typically depreciated over useful lives of over 40 years. If the utilities make investments of plant with useful lives of over 40 years to serve new core customers, then allowing these customers to opt out after just five years would leave these additional costs to be allocated to traditional core customers. The traditional core customers would then be responsible for the investments required to serve the switching noncore customers that were provided a higher level of service as core customers.

Consequently, those customers should not have the option of moving into and then out of core service, even for a five-year period.

We agree that the combination of the five-year commitment and the cross-over rate for the first 12 months of that five years will be sufficient to prevent price arbitrage and protect existing core customers. A five-year commitment is adequate to prevent opportunistic switching in and out of utility procurement service. The five-year commitment will allow the utilities to better plan contracts for gas supply and associated storage and interstate pipeline capacity.

4. Core Subscription

Core subscription has been the option (closed on an interim basis to additional customers on the SoCalGas system by Resolution G-3304) under which noncore customers have had ability to maintain their noncore status for transportation service priority (and rates), but take procurement service from the two utilities' core gas portfolios. In D.01-12-018 in Investigation (I.) 99-07-003, the Commission terminated core subscription. This issue therefore does not require further discussion in this proceeding.

5. Core Aggregation Transportation (CAT)

Under existing rules, any core customer switching from CAT marketer procurement service to utility procurement service pays the regular core procurement rate for such service, but must return to utility procurement service for a minimum of 12 months. The one exception is that the customer may switch to a different CAT marketer within 90 days of returning to utility procurement service. This exception can lead to gaming of the market place.

The greatest risk of gaming involves larger core customers. In order to prevent such gaming, SoCalGas and SDG&E propose new rules for core customers with annual consumption over 50,000 therms who want to switch from a CAT marketer to utility procurement service. The utilities propose that these customers should be required to pay the cross-over rate as described above for the first 12 months of utility procurement service. Should the Commission decide to give exemptions to customers whose marketer withdraws from California, then a core customer of the marketer consuming over 50,000 therms per year who returns to utility procurement service would not have to pay the cross-over rate. Such a customer would have 90 days to find a different CAT marketer or be committed to utility procurement service for a full 12 months. However, if the customer chose a different CAT marketer within 90 days, the customer would be charged the cross-over rate for the procurement service it received from the utility within those 90 days.

SoCalGas and SDG&E believe the potential for abuse by core customers under 50,000 therms is small enough due to transaction cost barriers that no change in the current CAT rules applicable to them is necessary. There is no objection to the utilities' proposal; it is reasonable as applied to each utility, and will be adopted.

6. The Long Beach Agreement

As discussed earlier in this decision, SoCalGas/SDG&E and Long Beach jointly presented a proposal for giving wholesale customers of SoCalGas an option to purchase gas from the consolidated SoCalGas/SDG&E gas portfolio. For the reasons elaborated earlier in this decision, those portfolios will remain separate. We need not address this proposal.

7. Tolling Arrangements

We have addressed our concerns with the applicants' proposed tolling agreements earlier in this decision and will not reiterate them here.

Consideration of this element of the application is unnecessary if the portfolios remain separate.

8. Impact of D.01-12-018

On December 11, 2001, the Commission issued D.01-12-018 in I.99-07-003, our investigation into gas regulatory strategy. D.01-12-018 adopted with modifications the Comprehensive Settlement Agreement (CSA) that had been submitted in that proceeding by numerous parties, including SoCalGas and SDG&E. Pursuant to a request for comments on whether D.01-12-018 affected any of the issues raised in this application, SoCalGas and SDG&E filed joint comments and SCGC filed comments.

The utilities say that the adoption of D.01-12-018 has some impacts on this application. D.01-12-018 provides that SoCalGas and SDG&E should no longer offer gas procurement service to noncore customers. Thus, terms and conditions of gas procurement service for noncore customers need not be adopted. Also D.01-12-018 lifted the prohibition on SoCalGas' noncore customers transferring to core service, but did not address any terms and conditions for such transfers. The CSA provides for contracts for utility procurement service to noncore customers already in existence to run to their conclusion, at which time the noncore customer could no longer take procurement service from the utility. Noncore customers in this category who fail to designate a marketer would be transferred to bundled core transportation and procurement service. We have considered in this application the terms and conditions for such transfers by both SoCalGas and SDG&E noncore customers. In regard to the transfer of a noncore customer to core status, D.01-12-018 stated:

> We note that G-3304 suspended transfers to core subscription service and core service as of December 20, 2000. As discussed above, it is our intention to provide customers with

> the option of choosing between noncore status, with its attendant responsibilities, and the bundled core. In order to provide this option, this decision rescinds that portion of Resolution G-3304 which suspended transfers to bundled core service, as of the effective date of this decision. (*mimeo.*, p. 90.)

SoCalGas Advice Letter 3100 filed on December 26, 2001, lifted the moratorium adopted in G-3304 on SoCalGas noncore customers transferring to core status.

In this application, SoCalGas and SDG&E proposed terms and conditions under which their noncore customers could elect to transfer to core status. They proposed that there be a limitation on which noncore customers could elect core status, excluding electric generation (EG), enhanced oil recovery (EOR) and refinery noncore customers from eligibility for this transfer. SoCalGas and SDG&E also proposed other restrictions discussed above in Section 3.

SCGC argues that because D.01-12-018 lifted the ban on noncore to core transfers, all noncore customers currently have the option of continuing with noncore service or transferring to bundled core service, contrary to what SoCalGas proposes. Rather than permitting noncore customers to have the option to transfer to core service, SoCalGas proposes to restrict the right to transfer to core service so as to prevent transfers by electric generation, refinery, and enhanced oil recovery customers who consume over 250,000 therms per year. SCGC says SoCalGas' proposal to restrict the opportunity for certain noncore customers to transfer from noncore to bundled core service flatly contradicts D.01-12-018. That decision grants to all noncore customers an option to transfer to bundled core service without restriction. Accordingly, SoCalGas' proposal to continue a prohibition on noncore to core transfers by electric generation, refinery, and enhanced oil recovery customers should be dismissed as an issue in this proceeding.

SCGC asserts that the SoCalGas/SDG&E proposal to combine core portfolios violates D.01-12-018 and should be dismissed as an issue. It argues that the utilities do not have the requisite capacity to serve the combined portfolio, and it would be speculative to assume that they would be able to get the capacity under the terms of the CSA. Given that we decline to combine the SoCalGas and SDG&E core portfolios, the question of whether consolidation is prohibited by D.01-12-018, is moot.

9. Comments on Draft Decision

The alternate proposed decision of Commissioner Lynch was mailed to the parties in accordance with Pub. Util. Code § 311(d) and Rule 77.1 of the Rules of Practice and Procedure. Comments were received on May 9, 2002 and reply comments were received on May 14, 2002. Comments to the alternate proposed decision are reflected in the body of this order.

Findings of Fact

1. In the 33 out of the 42 months prior to November 2000, SDG&E's prices were less than SoCalGas'.

2. At the time this application was filed, California border prices were many times higher than the basin plus full interstate transportation rate.

3. The vertical market power concerns raised in the context of the Pacific Enterprises/Enova merger are relevant to the consideration of SoCalGas' and SDG&E's core portfolios.

4. Applicants' tolling agreement proposed effectively re-introduces the electricity generation element that we ordered removed in D.98-03-073.

5. The addition of SDG&E's procurement to SoCalGas, the proposed consolidated portfolios involvement in tolling agreements, and opportunity to add incremental whole load to the consolidated portfolio add up to a significant increase in both scale and scope of SoCalGas' existing procurement operations.

6. Consolidating the utilities' core portfolios would eliminate a significant participant from the trading market at the California border.

7. Consolidating the utilities' core portfolios would expand the assets available for SoCalGas to use in generating additional revenues by physical gas transactions, capacity transactions, derivatives and hub transactions.

8. Either utility could acquire the benefit of supply diversity absent consolidation of the utilities' core procurement departments.

9. Applicants have not quantified the benefits of better management, training, and back-up.

10. The benchmark incentive mechanisms governing the utilities' respective gas purchases already provide streamlined, efficient regulation.

11. The projected $1 million in annual gas procurement overhead savings is negligible in the context of the utilities' overall portfolios.

12. On November 1, 2001, SoCalGas recovered 160 MMcfd of El Paso capacity; on January 1, 2002, it recovered an additional 50 MMcfd; on March 1, 2003, to comply with existing contracts, SoCalGas will transfer to third parties 100 MMcfd; on January 1, 2005, SoCalGas will recover 30 MMcfd of capacity. The amount of capacity that reverts to SoCalGas between November 1, 2001 and August 31, 2006 when the SoCalGas – El Paso contracts expire is never more than 210 MMcfd and after March 1, 2003, significantly less.

13. SDG&E's interstate capacity holdings are significantly less than its average daily core load.

14. It is appropriate to adopt uniform rules for election of core transportation and procurement service by noncore customers of each of the two utilities.

15. SoCalGas and SDG&E are not required to accept elections by noncore customers for core transportation service if existing utility intrastate capacity is not sufficient, to prevent service to traditional core customers becoming degraded.

16. Noncore customers who were already receiving core subscription service before January 1, 2001, are allowed to switch to bundled core transportation and utility procurement service on the effective date of this decision, if they are still on core subscription service as of that date, without having to pay the cross-over procurement rate.

Conclusions of Law

1. Consolidating the SoCalGas and SDG&E core procurement portfolios is not in the public interest because it will result in the removal of a significant participant in the California border market, will unnecessarily increase the scale

and scope of SoCalGas' procurement operations, and results in little tangible benefits.

2. It is reasonable for SoCalGas to first make available the interstate pipeline capacity that reverts back to its control, subject to the Federal Energy Regulatory Commission's regulations on releasing capacity, to its wholesale customers and other gas utilities that procure gas for core customers.

3. It is reasonable for SoCalGas and SDG&E to implement revised uniform rules for their noncore customers wishing to obtain core service from them.

4. A five-year customer commitment to procurement service is an adequate period to prevent customer switching and to facilitate utility asset planning.

5. It is reasonable for SoCalGas and SDG&E to implement revised uniform rules for large core customers who wish to obtain utility procurement service after having first elected transportation-only service.

O R D E R

IT IS ORDERED that:

1. The application of Southern California Gas Company (SoCalGas) and San Diego Gas & Electric Company (SDG&E) to consolidate their core gas procurement portfolios, is denied.

2. Unassigned El Paso capacity held by SoCalGas shall be made available first to SoCalGas' wholesale customers and other gas utilities who serve core customers, consistent with Federal Energy Regulatory Commission regulations.

3. Electric generation, refinery, and enhanced oil recovery (EOR) customers of either utility, any of whom consume over 250,000 therms per year, may not choose core transportation service or bundled core transportation and utility procurement service.

4. Other customers with noncore status, after expiration of any firm contracts they already have with their utility, have the option to switch to core transportation-only service or bundled core transportation and utility procurement service from SDG&E or SoCalGas, as appropriate. Noncore firm service customers have a one-time option to cancel their existing firm service contract in order to elect core service, provided the election occurs within three months of the effective date of the new service.

5. Noncore customers switching to bundled core transportation service and utility procurement service are required to pay a cross-over procurement rate for the first 12 months. The cross-over rate is the higher of a) the posted monthly core procurement rate (which will include intrastate backbone costs) or, b) the GCIM monthly benchmark for California border purchases plus the per-unit cost of intrastate backbone costs included in the posted monthly procurement rate.

6. Noncore customers who elect bundled core transportation and utility procurement service, shall be required to pay the cross-over rate for a period not to exceed 12 months after they commenced core subscription service from SDG&E.

7. Noncore customers electing transportation-only service or bundled transportation and utility procurement service are required to make a five-year commitment to that service.

8. Core customers with annual consumption over 50,000 therms who want to switch from a CAT marketer to utility procurement service may do so. These customers are required for the first 12 months of utility procurement service to pay the cross-over rate. A core customer consuming over 50,000 therms per year who returns to utility procurement service because his CAT left California does not have to pay the cross-over rate. Such a customer has 90 days to find a

different CAT marketer or be a committed to utility procurement service for a full 12 months. However, if the customer chose a different CAT marketer within 90 days, the customer will be charged the cross-over rate for the procurement service it received from the utility within those 90 days.

9. This proceeding is closed.

This order is effective today.

Dated ____________________________, at San Francisco, California.

ATTACHMENT A

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